

IN THE SUPERIOR COURT OF THE STATE OF DELAWARE
IN AND FOR KENT COUNTY

STERLING NETWORK EXCHANGE, LLC, :
STERLING TELECOM HOLDINGS, LLC, :
GEORGE D. SLESSMAN, WILLIAM D. : C.A. No. 07C-08-050WLW
SLESSMAN and ANTHONY L. WANGER, :

Plaintiffs, ::

v. :

DIGITAL PHOENIX VAN BUREN, LLC and :
DIGITAL SERVICES PHOENIX, LLC, :

Defendants. ::

DIGITAL PHOENIX VAN BUREN, LLC and :
DIGITAL SERVICES PHOENIX, LLC, :

Counterclaim Plaintiffs, :

v. :

STERLING NETWORK EXCHANGE, LLC, :
STERLING TELECOM HOLDINGS, LLC, :
GEORGE D. SLESSMAN, WILLIAM D. :
SLESSMAN and ANTHONY L. WANGER, :

Counterclaim Defendants. :

Submitted: December 28, 2007
Decided: March 28, 2008

Upon Plaintiffs' Motion to Dismiss Defendants'
Counterclaim. Granted in part; Denied in part.

Andre G. Bouchard, Esquire and Joel E. Friedlander, Esquire of Bouchard Margules & Friedlander, P.A., Wilmington, Delaware; attorneys for Plaintiffs and Counterclaim Defendants.

James L. Holzman, Esquire and Gary F. Traynor, Esquire of Prickett Jones & Elliott, P.A., Wilmington, Delaware; Kevin C. Logue, Esquire, of Paul Hastings Janofsky & Walker, LLP, New York, New York and Ronald M. Oster, Esquire and Jacob T. Risner, Esquire of Paul Hastings Janofsky & Walker, LLP, Los Angeles, California; attorneys for Defendants and Counterclaim Plaintiffs.

WITHAM, R.J.

In November 8, 2007, Plaintiffs/Counterclaim Defendants Sterling Network Exchange, LLC, Sterling Telecom Holdings, LLC, George D. Slessman, William D. Slessman, and Anthony L. Wanger (“Plaintiffs” or “Sterling”) filed a Motion to Dismiss Defendants’ and Counterclaim Plaintiffs’ (Digital Phoenix Van Buren, LLC (“Digital VB”) and Digital Services Phoenix, LLC’s (collectively, “Defendants” or “Digital”) counterclaim against Sterling, filed on October 19, 2007. Defendants filed a Memorandum in Opposition to Plaintiffs’ Motion to Dismiss Defendants’ Counterclaim on December 11, 2007. The Court heard oral argument on Monday, December 17, however, it was unable to rule from the bench due to the extensive submissions by the parties, requiring a comprehensive review.¹ Having considered the arguments, the Court grants the motion to dismiss as to the counterclaim relating to the purchase price component of the Sterling Network Services (“SNS”) Agreement and the Property Agreement. The Court denies the motion as to the portions of the counterclaim that relate to the remainder of the SNS Agreement and the unfair competition claim. The Court grants the motion as to the Master Services Agreement for lack of standing, however, it reserves the right to grant Digital leave to join SNS in the action.

Background

1. The Agreements

Digital’s counterclaim seeks to recover damages, including interest and attorneys’ fees, suffered by Digital as a result of alleged breaches of contract and

¹To expedite this matter, the Court will be brief in reciting the case history.

fraud committed by Plaintiffs. The counterclaim is rooted in the July 26, 2006 Digital acquisition of an approximately 350,000 square foot data center business facility located at 120 E. Van Buren Street in Phoenix, Arizona (“Property”) and the related entity, SNS, which sold, amongst other things, space and power to third party customers at the Property. Both parties to the transaction are considered sophisticated.

The purchase price for the sale of SNS was based upon an agreed to multiple of approximately twelve [12] times EBITDA², and the purchase price of the Property was based upon an agreed to multiple of approximately twelve [12] times NOI.³ Digital paid a total of \$171,703,038 for the property and SNS.⁴

This transaction involved three and possibly four agreements: the Property Agreement, the SNS Agreement (formally titled “Securities Purchase Agreement”), and the Escrow Agreement, and also, though at issue, a Master Services Agreement.⁵ Time limitations on claims are in all of the agreements. The Property Agreement contains a clause that limits the survival of representations and warranties to six months after closing. The SNS Agreement contains one clause that limits the survival of representations and warranties to one year after closing and another clause that

²Earnings Before Interest, Taxes, Depreciation, and Amortization.

³(Net Operating Income.)

⁴Defs.’ Answer & Countercl. ¶ 64.

⁵The Court was provided a copy of the SNS Agreement and the Master Services Agreement, but not the Property Agreement and the Escrow Agreement. Therefore on these latter two, it relies on the representations of the parties for the basis of its decision.

required Digital to contest errors in the closing price within 60 days. The SNS Agreement also contained a Non-competition, Non-solicitation [of customers or employees], Non-disparagement clause by which Sterling could not compete with Digital for six months from the purchase date (though it could lay the ground work for competition), solicit Digital customers or employees for one year, and could not directly or indirectly publicly disparage in any material respect to Digital. Both agreements contain provisions explicitly disclaiming any representations or warranties outside of the closing documents. Both agreements state that the closing documents constitute the entire agreement between the parties.⁶ Digital did not contest any errors in the closing price within 60 days of closing, or within the six-month period before the representations and warranties in the Property Agreement lapsed.

Pursuant to the Escrow Agreement, the parties set aside \$7 million (“the Escrow Fund”) at closing to be held to satisfy certain authorized claims (not including fraud). Digital can submit claims to the escrow agent through a written “Demand.” The Demand must be made within one year of the agreement and contain a good faith estimate of the amount to be reserved against the claim and a reasonable description of the bases of any such claims. If, in response, Sterling sends a “Dispute Notice” contesting the Demand, the money in dispute from the Escrow Fund cannot be released until the agent receives either a signed stipulation from both parties or a court order.

⁶Plaintiff’s Motion to Dismiss p 2.

The Master Services Agreement was originally between SNS (the related entity being acquired by Digital) and Sterling. It offered 2,000 square feet of the Managed Data Center services at a discounted price per month. Sterling agreed to pay for the services for an Initial Term of nine months. Digital asserts that it succeeded Sterling's rights and obligations under the Master Services Agreement on July 25, 2006, with the execution of the SNS Agreement. Sterling stopped paying its monthly fee after the first two months, allegedly breaching the Master Services Agreement.

Digital did not contest any errors in the SNS Agreement relating to the closing price within 60 days of closing and did not timely claim any breaches of the Property Agreement (six months).⁷ On July 25, 2007 (the day before the expiration of SNS Agreement representations and warranties), Digital sent a Demand on the escrow funds for breaches of the SNS Agreement and the Property Agreement. Sterling responded with a "Dispute Notice" contesting the Demand. The Dispute Notice contested the factual allegations contained in Digital's Demand, the reasonableness of the description of the bases of the alleged claims, and the reasonableness of the estimate of the amount to be reserved.⁸

Because of the competing claims on the Escrow Fund, Sterling filed its Complaint on August 31, 2007, seeking a declaration that it is entitled to the Escrow Fund. Digital filed an Answer and Counterclaim.

Delaware jurisdiction and venue are specifically selected in the parties' General

⁷Plaintiff's Motion to Dismiss p 3.

⁸Plaintiff's Motion to Dismiss p 3.

Escrow Agreement.⁹ For one of the Agreements, Arizona law is selected. The parties agree that as to the issues presented in this motion, the law is consistent in both Delaware and Arizona, and therefore Delaware law may be applied.¹⁰

2. Defendant Digital's Counterclaim

Digital's counterclaim alleges that since acquiring the Property and SNS, they discovered that Sterling made false contractual representations and warranties and materially breached other covenants and provisions of the contracts. Examples of these alleged false representations and warranties include that Sterling over-committed the available power capacity at the Property by signing 120 new contracts for which customers were promised more power than could be delivered, allegedly to inflate the sale price of the Property and SNS; falsely warranted SNS's liabilities¹¹ ("liabilities" are defined broadly);¹² that values were not based on a business that has been conducted in the ordinary course and were inconsistent in all material respect with past practice, as had been represented;¹³ falsely represented that the capacity of the utility services at the Property was adequate; falsely represented that all Liabilities and contracts had been disclosed and that the books and records reflected the same; falsely represented that the Assets constituted all the properties, assets, and rights as

⁹Defs.' Answer & Countercl. ¶ 67 (*citing* § 11 General Escrow Agreement; § 9.11 Securities Purchase Agreement).

¹⁰Motion Hearing Transcript at 50 (Dec. 17, 2007) (hereinafter "Tr.").

¹¹Counterclaim ¶¶ 124, 126 (*citing* Sections 3.07 and 3.08 of the SNS Agreement).

¹²Counterclaim ¶124 (referring to the definitions section of the SNS Agreement).

¹³Counterclaim ¶125.

are necessary in the conduct of the Business, and are in adequate operating condition and repair, ordinary wear and tear excepted, and are suitable for the purposes for which they are used; and had improperly destroyed and failed to preserve books and records of the company, including but not limited to email evidence, among other contractual breaches.¹⁴

Digital claims that Digital requested the due diligence items specified in the Letter of Intent, but Sterling resisted production of such items, citing competitive and proprietary concerns. For the same reasons, Digital claims that Sterling severely restricted Digital's access to the Property prior to closing on July 25, 2006. Instead, only brief walkthrough tours were allowed, guided by George Slessman. Digital was not provided access to Sterling employees. Sterling did not consent to Digital discussing the Property with the supplier of power to the Property. The power supplier would not discuss the Property with Digital without prior consent from the Property owner, Sterling. Also, for the same reasons, Sterling refused to allow access to any of their customers prior to closing. Therefore, Digital was forced to rely upon Sterling's representations prior to closing.¹⁵ Digital also asserts that the "Property is, in general, an improperly engineered building. There is not enough power coming into the building, not enough generator capacity, not enough UPS systems, and not enough cooling infrastructure."¹⁶

¹⁴Defs.' Answer & Countercl. ¶¶65. These counterclaims are described in detail at ¶¶109-183.

¹⁵Defs.' Answer & Countercl. ¶¶ 119-133.

¹⁶Defs.' Answer & Countercl. ¶147. "UPS" likely stands for "Uninterruptible Power Supply" which provides for a continuous supply of electric power,

These alleged false representations, breaches of warranties and contracts, allegedly caused Digital to pay a substantially and improperly inflated purchase price for the facility, caused them to suffer, and will continue to suffer, substantial additional damages, including, but not limited to, the expenditure of more than \$20 million to remedy various shortcomings at the Property so that Digital can provide service and meet commitments to customers that were existing as of the closing date. Digital alleges that they are therefore entitled to the entire balance of the Escrow Fund and to recover such additional damages that are proven at trial, together with interest and attorneys' fees.¹⁷

Digital also prays for dismissal of Sterling's Complaint with prejudice and entry of judgment on Digital's Counterclaim in favor of Digital and against Sterling.¹⁸

3. Plaintiffs Sterling's Motion to Dismiss

First, Plaintiffs Sterling argue that most of Defendant Digital's claims are barred by time limitations. Any claims made under the Property Agreement expired more than five months before Defendants Digital provided any notice to a claim on the Escrow Fund. Any challenges to the purchase price expired 60 days after purchase. Although Defendants' claims arising under the SNS Agreement and surviving components of the Escrow Agreement have a one-year expiration date, their Demand letter did not provide a "good faith estimate of the amount" to be reserved

http://en.wikipedia.org/wiki/Uninterruptible_power_supply (last modified March 24, 2008).

¹⁷Def's.' Answer & Countercl. ¶ 66.

¹⁸Prayer for the individual accounts are detailed in (A) - (D) in Digital's Prayer for Relief, Counterclaim p 58.

against the claim nor a “reasonable description of the bases of any such claims.”¹⁹ Plaintiffs argue that since Defendants’ assertions were raised for the first time in the October 19, 2007 Counterclaim, they are time-barred from asserting them.

Second, Plaintiffs argue that since Defendant agreed to purchase the building “as-is,” they fail to state a claim upon which relief can be granted. Plaintiffs Sterling assert that they merely represented that the power supply was adequate for its current use and did not warrant the building to supply power for any alleged future or new commitments by Defendants. To the extent that Digital believed they were purchasing a building with a certain level of redundant power supply,²⁰ those representations were not contained in the contract and are therefore explicitly disclaimed.

Third, Plaintiffs argue that the alleged malicious oversubscription of power to tenants and customers without disclosure to Defendants is false. Plaintiffs assert that they provided all of Sterling’s existing service contracts and Leases in the SNS Agreement prior to execution. Plaintiffs argue that the plain terms of the SNS Agreement did not obligate them to disclose any liabilities stemming from customer contracts. The SNS Agreement does not contemplate future power commitments, and therefore Sterling could not have breached on that subject even if failure to disclose had occurred. Plaintiffs argue that their only obligation was to supply power to existing tenants and customers. Finally, Plaintiffs argue that Defendants’ complaint

¹⁹Pls.’ Mot. to Dismiss Defs’ Countercl. 6.

²⁰Specifically, a 2(N+1) power supply.

that the oral representations made prior to the execution of the agreements are without merit because of the SNS Agreement's and Property Agreement's integration clause.

Fourth, Plaintiffs argue that Defendants' fraud claim failed to plead fraud with the requisite particularity, per Rule 9(b).

Fifth, Plaintiffs argue that the unfair competition claim must be dismissed because it is preempted and because the count does not provide enough facts for Defendants to prevail.

Lastly, Plaintiffs argue that the Master Services Agreement Breach claim fails for lack of standing.

4. Defendants' Response

The following is a *brief* summary of Defendant's response arguments. Regarding the Property, Defendants contend that Plaintiffs' arguments fail because the Property Agreement does not waive the representations, warranties or other provisions found in the SNS Agreement. Second, Defendants argue that Plaintiffs' "as-is" argument is wrong, and support their argument with a quote from Paragraph 7.1 of the Property Agreement. Third, Defendants claim that they have in fact pleaded fraud with particularity because they refer to misrepresentations made within the contract, not outside the contract.²¹ Fourth, Defendants assert that they have a valid unfair competition claim and that it is pleading sufficiently, and though they do not cite to it, the Court notes that Section 5.06 of the SNS Agreement does provide

²¹Defs.' Mem. In Opp'n to Pls.' Mot. to Dismiss Defs.' Countercl. 10.

Non-competition, Non-solicitation, Non-disparagement clause.²² Fifth and finally, Defendants argue that they do have standing to pursue its Master Services Agreement Claim because Digital succeeded to SNS's rights and obligations via the execution of the SNS Agreement. That since the Property Agreement expressly contemplated the existence of the SNS Agreement, which sold SNS to Digital, Sterling expressly consented to the acquisition of SNS by Digital when it signed the Property Agreement, and received actual notice of this acquisition through the Property Agreement, through its sole member, Sterling Telecom, and through the closing negotiations, which involved all parties.

Standard of Review

Delaware has clear standards for granting a Rule 12(b)(6) Motion to Dismiss.²³ The Court must accept all well-pled allegations as true.²⁴ The Court must then apply a broad sufficiency test: whether a plaintiff may recover under any conceivable set of circumstances susceptible of proof under the complaint.²⁵ Dismissal will not be granted if the complaint gives general notice as to the nature of the claim asserted

²²Defs.' Mem. In Opp'n to Pls.' Mot. to Dismiss Defs.' Countercl. 12 (citing *Total Care Physicians, P.A. v. O'Hara*, 798 A.2d 1043, 1057 (Del. Super. 2001) (stating that "The elements of the tort of unfair competition are that the plaintiff has a reasonable expectancy of entering a valid business relationship, with which the defendant wrongfully interferes, and thereby defeats the plaintiff's legitimate expectancy and causes him harm.")).

²³*Lesh v. Appriva Medical, Inc.* 2006 WL 2788183, *3 (Del. Super.).

²⁴*Id.*

²⁵*Id.* citing to *Spence v. Funk*, 396 A.2d 967, 968 (Del. 1978).

against the Defendant.²⁶ Further, a complaint will not be dismissed unless it is clearly without merit, which may be either matter of law or fact.²⁷ Vagueness or lack of detail, standing alone, is insufficient to dismiss a claim.²⁸ If there is a basis upon which the Plaintiff may recover, the motion is denied.²⁹

Discussion

The facts in this case are contentious and complicated and therefore are of the nature for which the Court ordinarily would be hesitant to grant a motion to dismiss. However, Digital's claims raised under the Property Agreement and that portion of the SNS Agreement dealing with the purchase price face contractual time limitations restricting the time in which Digital may bring claims.³⁰ The limitations on both claims expired by the time Digital provided written notice of their claim (the "Demand"). Given that the parties are sophisticated, the contracts themselves are read strictly, and Digital is therefore bound by the time limitations and methods of notice that they agreed to at signing.³¹

Digital argues that the *Abry Partners V, L.P. v. F & W Acquisition LLC*³²

²⁶*Id.*

²⁷*Id.* citing to *Diamond State Tel. Co. v. University of Delaware*, 269 A.2d 52, 58 (Del. 1970).

²⁸*Id.*

²⁹*Id.*

³⁰As described above, claims regarding the Property Agreement expired 6 months after closing; claims regarding the purchase prices expired 60 days after closing. Digital did not provide written notice to Sterling about its claims until the day before the one-year anniversary of the closing.

³¹*Abry Partners V, L.P. v. F & W Acquisition LLC*, 891 A.2d 1032, 1061 (Del.Ch.,2006).

³²*Id.*

decision carves an exception to the four corners of a contract rule where fraud is alleged. *Abry* underscored Delaware courts’ “distaste for immunizing fraud.”³³ That case also involved a sophisticated buyer and seller and contractual limitations on a party’s ability to bring a fraud claim.³⁴ However, the contract at issue in that case, in contrast to this one, failed to provide a reasonable period of opportunity to unearth possible misrepresentations. Here, there was such an opportunity and Digital failed to provide written notice within that time frame. Therefore, because of the 60-day purchase price statute of limitation and the 6-month Property Agreement statute of limitation, Digital’s claims are barred.

As to the Master Services Agreement, there was no evidence that an assignment of SNS rights to Digital was noticed to Sterling, in accordance with the Agreement. The Agreement’s language is clear—only in the event that written notice was given may there be an assignment. Therefore, Digital does not have standing to bring claims regarding the Master Services Agreement. Digital requested that if the Court finds for lack of standing, that the Court grant it leave to amend that Complaint so that it may join SNS. Superior Court Civil Procedure Rule 15(a), allows the Court to grant leave when “justice so requires.”³⁵ Since the Master Services Agreement provided that Sterling would pay the Initial Term of nine months, and Sterling in fact paid for the first two months before stopping payment without any justification, the

³³*Id.*

³⁴*Id.*

³⁵Super. Ct. Civ. Proc. R. 15(a).

Court grants Digital leave to amend the Complaint on this limited issue.

Regarding the remainder of the SNS Agreement, outstanding claims involve various interpretations of the Agreement, false representations and fraud. These claims are not barred by the statute of limitations as Digital provided written notice to Sterling within the required period of one year. At this point, Sterling shifts its argument from statute of limitations to failure to plead with the requisite particularity.

Sterling correctly represents that Superior Court Civil Rule 9(b) requires that “in all averments of fraud, . . . the circumstances constituting fraud . . . shall be stated with particularity.”³⁶ “Circumstances” include “the time, place, and contents of the false representations, as well as the identity of the person making the misrepresentation as well as what he obtained thereby.”³⁷ “Malice, intent, knowledge and other condition of mind of a person may be averred generally.”³⁸ Public policy explains Rule 9(b), in that fraud is a claim that can be so vague or ambiguous that in fairness, it must be plead with particularity so that the parties are on notice as to what is being adjudicated.³⁹ Thus, “[i]t may not be necessary that all evidence of fraud within the knowledge of the plaintiffs be disclosed short of discovery, but it is essential that the precise theory of fraud with supporting specifics appear in the

³⁶Super. Ct. Civ. Proc. R. 9(b).

³⁷*Crowhorn v. Nationwide Mut. Ins. Co.*, 2001 WL 695542 *4 (Del.Super., April 26, 2001) (citing *Nutt v. A.C. & S., Inc.*, 466 A.2d 18, 23 (Del.Super. 1983) (quoting *Autrey v. Chemtrust Industries Corp.*, 362 F.Supp. 1085, 1092, 1093 (D.Del. 1973))).

³⁸*Crowhorn* at *4 (quoting Super. Ct. Civ. Proc. R. 9(b)).

³⁹*Crowhorn* at *5.

complaint.”⁴⁰ Specifically, the following elements must be met in order to satisfy Rule 9(b):

- (1) a false representation, usually of fact, made by the defendant; (2) the defendant’s knowledge or belief that the representation was false, or was made with reckless indifference to the truth; (3) an intent to induce the plaintiff to act or to refrain from acting; (4) the plaintiff’s action or inaction was taken in justifiable reliance upon the representation; and (5) damage to the plaintiff as a result of such reliance.⁴¹

Digital alleges that Sterling “lured people in [to contracts]” during the 8-9 month period between signing the Letter of Intent and the closing in order to escalate the purchase price. These new customers entered into contracts upon the representation that there was sufficient power capacity for them, when in fact there was not. Therefore these customers, in existence at the time of closing and upon which the purchase price was based, are dissatisfied with their service and are leaving. Although the most straightforward result of these false representations is inflation of the purchase price, for which Digital is now barred from claiming, Digital also cites damages outside of the purchase price, for example its expenditures to maintain customer demands consistent with and contracted for at the time of the purchase. Sterling represented that the business had been operated in its ordinary course and that it could meet its contract demands. In reality, however, Sterling

⁴⁰*Id.* (citing *Nutt v. A.C. & S.*, 466 A.2d 18, 23 (Del.Supr. 1983)).

⁴¹*Crowhorn* at *5 (quoting *Stephenson v. Capano Development, Inc.*, 462 A.2d 1069, 1074 (Del. 1983)).

allegedly sold 120 new contracts that pushed the business over its represented power capacity. Digital, for the purposes of this motion, need not prevail on this claim, but merely meet the requisites for pleading fraud.⁴²

Finally, regarding Digital's unfair competition claim, for which Sterling asserts that Digital has failed to identify any violation of this clause, Digital has in fact alleged that Sterling has recruited its employees, customers, and soiled its name as not having the power supply represented (and that Sterling, now up and running as a competitor, does). To succeed on an unfair competition claim, Digital must establish "a reasonable expectancy of entering a valid business relationship, with which the defendant wrongfully interferes, and thereby defeats the plaintiff's legitimate expectancy and causes him harm."⁴³ Given that there is a clause in the SNS Agreement specifically forbidding Sterling's alleged actions, Digital reasonably relied on Sterling to perform the Agreement as contracted, and that Digital sufficiently described the resulting harm (loss of employees, customers, trade secrets and soiled public reputation), the Court finds the pleading is sufficient for the purposes of this motion.

⁴²Digital submitted a 50-page counterclaim and a 15-page memorandum which provided the facts described in the *Background* section above. The Court does not believe Sterling's argument that it is not on notice of the nature of Digital's fraud claims.

⁴³Plaintiffs' Motion to Dismiss Defendants' Counterclaim at 13 (*citing Total Care Physicians, P.A. v. O'Hara*, 798 A.2d 1043, 1057 -1058 (Del.Super. 2001) (citations omitted)).

Sterling Network Exchange v. Digital Phoenix Van Buren
C.A. No. 07C-08-050WLW
March 28, 2008

Conclusion

Due to the tolling of the contractual statute of limitations, the Court grants Plaintiffs Sterling's motion to dismiss as to the counterclaims relating to the purchase price component of the SNS Agreement and the Property Agreement. Because facts are otherwise in issue and Digital's claims are not barred by the contractual statute of limitations, the Court denies the motion as to the portions of the counterclaim that relate to the remainder of the SNS Agreement and the unfair competition claim. The Court grants the motion as to the Master Services Agreement for lack of standing, however, it reserves the right to grant Digital leave to join SNS in the action.

IT IS SO ORDERED.

/s/ William L. Witham, Jr.
R.J.

WLW/dmh
oc: Prothonotary
xc: Order Distribution